DEPARTMENT OF STATE REVENUE

04-20110274.LOF

Letter of Findings Number: 04-20110274
Sales Tax
For Tax Years 2006-09

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ISSUES

I. Sales Tax–Food Items.

Authority: IC § 6-2.5-1-11; IC § 6-2.5-1-6; IC § 6-2.5-1-16; IC § 6-2.5-1-20; IC § 6-2.5-1-26; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-20; IC § 6-8.1-5-1; 45 IAC 2.2-1-1; 45 IAC 2.2-3-4; Streamlined Sales and Use Tax Agreement (May 19, 2011).

Taxpayer protests the imposition of sales tax on items it sold as a retail merchant.

II. Use Tax–Imposition.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-5; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-8.1-5-1; 45 IAC 2.2-1-1; 45 IAC 2.2-3-4; 45 IAC 2.2-4-2.

Taxpayer protests the imposition of use tax on some purchases it made during the audit period.

III. Tax Administration–Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer operates retail stores in Indiana and other states. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not been collecting and remitting sales tax on some items it sold in its stores which were subject to sales tax. Also, the Department determined that Taxpayer had not paid sales tax on items it used in its Indiana operations. The Department therefore issued proposed assessments for sales tax, use tax, interest, and ten percent negligence penalties for the tax years 2006, 2007, 2008, and 2009. Taxpayer disagreed with some of the items listed as taxable and filed a protest of the imposition of a portion of the sales tax, use tax, and of the imposition of penalties. Through correspondence conducted prior to an administrative hearing, most of the items listed as subject to sales tax were removed from the list of taxable items. An administrative hearing was held concerning the remaining items. Taxpayer provided additional documentation and analysis and this Letter of Findings results. Further facts will be presented as required.

I. Sales Tax–Food Items.

DISCUSSION

Taxpayer protests the imposition of sales tax on several items it believes are exempt food items. Taxpayer states that the Department misclassified these items as taxable and that they should be removed from the Department's calculations of sales tax due. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as required by IC § 6-8.1-5-1(c).

The Department refers to IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state. (Emphasis added).

IC § 6-2.5-5-20 provides:

(a) Sales of food and food ingredients for human consumption are exempt from the state gross retail tax.

(b) For purposes of this section, the term "food and food ingredients for human consumption" includes the following items if sold without eating utensils provided by the seller:

(1) Food sold by a seller whose proper primary NAICS classification is manufacturing in sector 311, except subsector 3118 (bakeries).

(2) Food sold in an unheated state by weight or volume as a single item.

(3) Bakery items, including bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, danish, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas.

(c) Except as otherwise provided by subsection (b), for purposes of this section, the term "food and food ingredients for human consumption" does not include:

(1) candy;

(2) alcoholic beverages;

(3) soft drinks;

(4) food sold through a vending machine;
(5) food sold in a heated state or heated by the seller;
(6) two (2) or more food ingredients mixed or combined by the seller for sale as a single item (other than food that is only cut, repackaged, or pasteurized by the seller, and eggs, fish, meat, poultry, and foods containing these raw animal foods requiring cooking by the consumer as recommended by the federal Food and Drug Administration in chapter 3, subpart 3-401.11 of its Food Code so as to prevent food borne illnesses);
(7) food sold with eating utensils provided by the seller, including plates, knives, forks, spoons, glasses, cups, napkins, or straws (for purposes of this subdivision, a plate does not include a container or packaging used to transport the food); or
(8) tobacco.

(Emphasis added).

IC § 6-2.5-1-20 defines "food and food ingredients" as:

"Food and food ingredients" means substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and that are consumed for their taste or nutritional value. The term does not include alcoholic beverages, candy, dietary supplements, tobacco products, or soft drinks.

(Emphasis added).

IC § 6-2.5-1-26 provides:

"Soft drinks" means nonalcoholic beverages that contain natural or artificial sweeteners. The term does not include beverages that contain milk or milk products, soy, rice, or similar milk substitutes, or greater than fifty percent (50[percent]) of vegetable or fruit juice by volume.

IC § 6-2.5-1-16 defines "dietary supplements" as:

"Dietary supplement" means any product, other than tobacco, that:
(1) is intended to supplement the diet;
(2) contains one (1) or more of the following dietary ingredients:
(A) a vitamin;
(B) a mineral;
(C) an herb or other botanical;
(D) an amino acid;
(E) a dietary substance for use by humans to supplement the diet by increasing the total dietary intake; or
(F) a concentrate, a metabolite, a constituent, an extract, or a combination of any ingredient described in this subdivision;
(3) is intended for ingestion in tablet, capsule, powder, softgel, gelcap, or liquid form, or, if not intended for ingestion in such a form, is not represented as conventional food and is not represented for use as a sole item of a meal or of the diet; and
(4) is required to be labeled as a dietary supplement, identifiable by the "Supplemental Facts" box found on the label and as required under 21 CFR 101.36.

(Emphasis added.)

Therefore, whether or not an item qualifies for the exemption provided by IC § 6-2.5-5-20 is a fact-sensitive issue. As mentioned above, Taxpayer was able to provide documentation regarding most items originally listed as taxable in the Department's audit report. There were two remaining categories at issue.

The first category is for items under the brand names "Boost" and "Ensure." Taxpayer must demonstrate that they are not "soda drinks," by showing that the drinks that contain natural or artificial sweeteners, also contain milk or milk products, soy, rice or similar milk substitutes, or more than 50 percent fruit or vegetable juice by volume, as provided by IC § 6-2.5-1-26. After review of the information supplied by Taxpayer, both Boost and Ensure contain filtered milk. Those two items are therefore not soda drinks as defined by IC § 6-2.5-1-26 and are exempt from sales tax as provided by IC § 6-2.5-5-20.

The second category under protest is an item by the brand name "Coors Cutter." This item was included as taxable since it was assumed to be an alcoholic beverage, which not a food item under IC § 6-2.5-1-20 and is therefore taxable under IC § 6-2.5-5-20(c). At hearing, Taxpayer provided documentation in support of two points. The first point is that Coors Cutter was a non-alcoholic beverage and was marketed as such. The second point is that the Coors brewing company discontinued the Cutter product prior to the audit period.

Regarding Taxpayer's first point, while the product was marketed as "non-alcoholic" beer, IC § 6-2.5-1-11 states:

"Alcoholic beverages" means beverages that are suitable for human consumption and contain one-half of one percent (0.5[percent]) or more of alcohol by volume.

Also, the definition of "Alcoholic Beverage" provided in the Streamlined Sales and Use Tax Agreement (May 19, 2011) ("SSUTA") is:

"Alcoholic Beverages" means beverages that are suitable for human consumption and contain one-half of

one percent or more of alcohol by volume.

Indiana is a signatory to the SSUTA and abides by its definitions. Coors Cutter contained one half of one percent alcohol by volume. Therefore, even though the product was marketed as "non-alcoholic", it was defined as "alcoholic" by the SSUTA and was a taxable item.

Regarding Taxpayer's second point, while "Coors Cutter" was discontinued prior to the audit period, beginning in 1997 Coors began production of a non-alcoholic beer under the brand name "Coors NA." That product also contains one half of one percent alcohol by volume. Since there were sales in the category labeled "Coors Cutter" which were then included as taxable sales, and since Coors does make a product comparable to "Coors Cutter" it is reasonable for the Department to assume that the sales in that category were for the new product, which is a taxable "alcoholic" beer as defined by the SSUTA.

In conclusion, Boost and Ensure are exempt food items and will be removed from the Department's calculations of taxable items. Sales in the category labeled "Coors Cutter" will remain in the Department's calculations of taxable items since there were sales for something in that category and since it is reasonable to assume that the other, comparable Coors product was what was actually sold and listed in that category. Also, "non-alcoholic" beers with at least one-half of one percent alcohol by volume are defined as "alcoholic beverages" in the SSUTA. Coors Cutter contained and Coors NA contains one-half of one percent alcohol by volume and were/are therefore taxable alcoholic beverages.

FINDING

Taxpayer's protest is sustained in part and denied in part, as provided above.

II. Use Tax–Imposition.

DISCUSSION

Taxpayer protests the imposition of use tax on certain purchases it made for items it used in its business operations but upon which it did not pay Indiana sales tax at the time of purchase. Taxpayer states that these items were not subject to Indiana sales or use taxes and that use tax is not due on those purchases. Due to the volume of purchases in question, the Department employed a sample and projection method to determine Taxpayer's use tax compliance for the years in question. Taxpayer believes that certain items should be removed from the calculations of taxable items in the sample and that its projected use tax liabilities should be reduced. At the administrative hearing, Taxpayer discussed twenty-one (21) categories of items which it believes should be reclassified as non-taxable in the Department's use tax calculations. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

(a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, 45 IAC 2.2-3-4 provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. In this case, the Department determined that Taxpayer had acquired tangible personal property in retail transactions and used that property in Indiana without paying sales tax at the point of purchase. The Department therefore issued proposed assessments for use tax, as provided by 45 IAC 2.2-3-4.

As part of the protest process, Taxpayer provided documentation and analysis supporting its position. Taxpayer listed twenty-one categories of items it protested were not subject to Indiana use tax. Of those categories, several were for items which were delivered to Taxpayer's stores in states other than Indiana. Taxpayer provided invoices to support its position that categories 2, 7, 13, 14, 15, 16, 17, 18, and 19 were deliveries to out-of-state locations. Since the items in question were stored, used, or consumed outside Indiana, Indiana use tax is not due on those purchases and those items will be removed from the Department's calculations of use tax due.

Next, Taxpayer provided copies of invoices which show that Taxpayer paid Indiana sales tax on certain items at the time of purchase. Categories 6 and 10 concern such purchases. Since sales tax was paid at the time of purchase, use tax is not due as provided by 45 IAC 2.2-3-4. Therefore, those items will be removed from the Department's calculations of use tax due.

Next, Taxpayer provided copies of invoices from two of its vendors in support of the position that those

vendors were charging sales tax on sales to Taxpayer. The invoices provided were not for the purchases included in the sample used by the Department in its use tax sample and projection method. Still, Taxpayer believes that the invoices provided show a pattern of sales tax collection and that the Department should remove all purchases from these vendors from its use tax calculations.

The Department cannot agree with this position. There is no guarantee that the vendors in question charged sales tax on the purchases listed in the sample population used in the use tax calculations. Taxpayer has not met the burden of proving this portion of the proposed assessments wrong, as required by IC §6-8.1-5-1(c), and the amounts listed in categories 4 and 12 will remain classified as taxable in the Department's use tax calculations.

Next, Taxpayer provided copies of invoices regarding charges from some of its vendors referring to "travel charges" or "trip charges." Taxpayer states that these charges were for the service of trucking/hauling the tangible personal property which Taxpayer was purchasing from the vendors. The Department considered the charges to be subject to sales and use tax and refers to IC § 6-2.5-1-5(a), which provided (as in effect during the audit period):

> (a) Except as provided in subsection (b), "gross retail income" means the total amount of consideration, including cash, credit, property, and services, for which tangible personal property is sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for:
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> (1) the seller's cost of the property sold;
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> (2) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
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> (3) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
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> (4) delivery charges; or
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> (5) consideration received by the seller from a third party if:
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> (A) the seller actually receives consideration from a party other than the purchaser and the consideration is directly related to a price reduction or discount on the sale;
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> (B) the seller has an obligation to pass the price reduction or discount through to the purchaser;
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> (C) the amount of the consideration attributable to the sale is fixed and determinable by the seller at the time of the sale of the item to the purchaser; and
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> (D) the price reduction or discount is identified as a third party price reduction or discount on the invoice received by the purchaser or on a coupon, certificate, or other documentation presented by the purchaser.
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> For purposes of subdivision (4), delivery charges are charges by the seller for preparation and delivery of the property to a location designated by the purchaser of property, including but not limited to transportation, shipping, postage, handling, crating, and packing.
>
> (Emphasis added).
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> Also, IC § 6-2.5-4-1(e) provides:
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> The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:
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> (1) the price of the property transferred, without the rendition of any service; and
>
> (2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records. For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.
>
> (Emphasis added).

Therefore, while the charges listed in categories 1 and 5 were not directly for the purchase of tangible personal property, they were delivery charges as defined by IC § 6-2.5-1-5(a)(5)(D) and are properly subject to Indiana sales or use tax.

Next, Taxpayer protests the inclusion of purchases from a particular vendor which produces over-the-counter medical items. Taxpayer states that, since these are medical items and since Taxpayer is a business which would not use medical items, the amounts it paid to that vendor should be removed from the Department's use tax calculations. After review of the materials submitted regarding this particular vendor, it is clear that these were items for resale and not for Taxpayer's use. As such, all amounts listed in Taxpayer's category 21 will be reclassified as non-taxable in the Department's use tax calculations.

Next, Taxpayer protests the inclusion of transactions which Taxpayer states were purely services without the transfer of tangible personal property. Of the vendors included in this portion of Taxpayer's protest, one is for a floor cleaning service which included a truck charge as discussed above. While the truck charges are taxable if there is a transfer of tangible personal property, here there was only a cleaning service with a de minimis transfer of tangible personal property. Also, one invoice is a bank fee, which also does not involve the transfer of tangible personal property. A third invoice is for a service which pipes music into Taxpayer's stores. Again, there is no transfer of tangible personal property involved with this vendor. Therefore, the amounts paid under categories 8,

9, and 3 will be reclassified as non-taxable in the Department's use tax calculations.

However, two other vendors included in this portion of Taxpayer's protest did have transfers of tangible personal property involved in the transactions at issue. One vendor was a painting service and the other was a parking lot maintenance service. The invoices for the painting service list labor, materials, and delivery charges on a single invoice. The relevant statute is IC § 6-2.5-1-1, which states:

(a) Except as provided in subsection (b), "unitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.

(b) "Unitary transaction" as it applies to the furnishing of public utility commodities or services means the public utility commodities and services which are invoiced in a single bill or statement for payment by the consumer.

Also, 45 IAC 2.2-1-1(a) states:

Unitary Transaction. For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

Finally, 45 IAC 2.2-4-2 states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

The invoices provided during the protest do not establish Taxpayer's position. The invoices for the painting show that, for those particular transactions, the amount of tangible personal property is less than ten percent of the service charge. As discussed previously, these invoices are not those listed in the sample population used by the Department in its use tax calculations. Taxpayer wants the Department to consider the invoices it provided as establishing a pattern which could be extended to the invoices listed in the sample population. As discussed above, the Department cannot agree with this method. All painting jobs are not identical and there is no guarantee that the jobs listed in the sample population involved transfers of less than ten percent of the service price, as required by 45 IAC 2.2-4-2(a).

The parking lot maintenance invoices do not break down costs at all. There is only a single price listed for the transaction. Since the invoices are for such activities as patching holes, it is reasonable for the Department to assume that some transfer of tangible personal property takes place. Taxpayer has not established that the amount charged for tangible personal property is less than ten percent of the service charge, as required by 45 IAC 2.2-4-2(a). Therefore, the amounts listed in categories 11 and 20 will remain listed as taxable in the Department's use tax calculations.

In conclusion, Taxpayer and the Department agreed to substantially reduce the proposed sales tax liabilities prior to the administrative hearing. Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) regarding categories 2, 3, 6, 7, 8, 9, 10, 13, 14, 15, 16, 17, 18, 19, and 21. Taxpayer has not met the burden imposed under IC § 6-8.1-5-1(c) regarding categories 1, 4, 5, 11, 12, and 20. A supplemental audit will recalculate the use tax liabilities reflecting these findings.

FINDING

Taxpayer's protest is sustained in part and denied in part, as provided above.

III. Tax Administration–Negligence Penalty.

DISCUSSION

The Department issued a proposed assessment and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty and states that it acted reasonably in its sales and use tax duties. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

. . .

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

. . .

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(Emphasis added).

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer incurred an assessment which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer states that it acted reasonably and that it had a reasonable basis for believing that the items discussed in Issues I and II above were exempt from sales and use tax. After review of the circumstances in this case, Taxpayer has been sustained on most items protested in Issue I above and a substantial portion of the items listed in Issue II. Taxpayer has established that the assessment of additional use tax on these remaining items arose due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer is sustained in Issue I regarding its sales of Boost and Ensure. Taxpayer is denied in Issue I regarding the sale of "non-alcoholic" beer, for the reasons listed in Issue I. Taxpayer is sustained in Issue II for categories 2, 3, 6, 7, 8, 9, 10, 13, 14, 15, 16, 17, 18, 19, and 21. Taxpayer is denied in Issue II for categories 1, 4, 5, 11, 12, and 20. Taxpayer is sustained in Issue III regarding the imposition of negligence penalty. As noted above, the Department agreed to substantial reductions in the proposed assessments prior to the administrative hearing. To the extent that any of those agreed-upon amounts are duplicated in this Letter of Findings, any adjustments will only be made once in a supplemental audit.

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